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Stigma over T-Bills Persists as Investors Focus on “Sophistication”

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25 November 2018

Online at <https://mpra.ub.uni-muenchen.de/90378/>

MPRA Paper No. 90378, posted 5 December 2018 09:08 UTC

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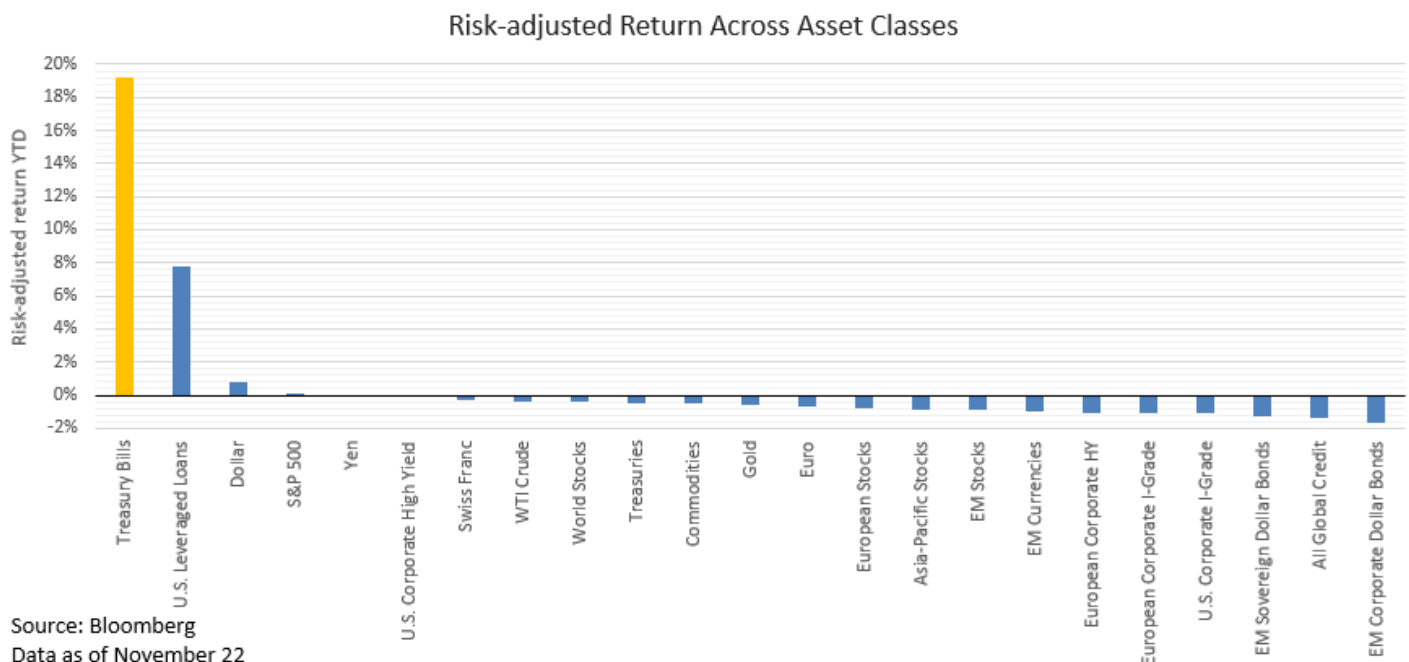
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Executive Summary

- Treasury bills outperformed a broad cohort of asset classes following this year’s violent bouts of risk-parity unwind
- Rising deficit, retreats from globalization, and waning stimulus are bullish to high quality low duration instruments
- T-bills provide an effective hedge to a hawkish rate path, for higher short-term rates would improve portfolio carry
- “Cash is taboo” arose from past decade of reach-for-yield where “sophistication” was needed to counter low rates
- Asset managers remain hesitant to hold T-bills in size for fears that perception of “inactivity” would harm prestige
- Some managers expressed concerns that “unsophisticated” allocations would raise questions over compensation

Treasury bills triumphant amid risk-parity carnage

Following several violent bouts of risk-parity unwind where long maturity sovereign bonds and wide range of risk assets weakened in tandem, Treasury Bills emerged as the instrument with unmatched year-to-date risk-adjusted return at 19.24%, according to [Bloomberg data as of November 22nd](#):



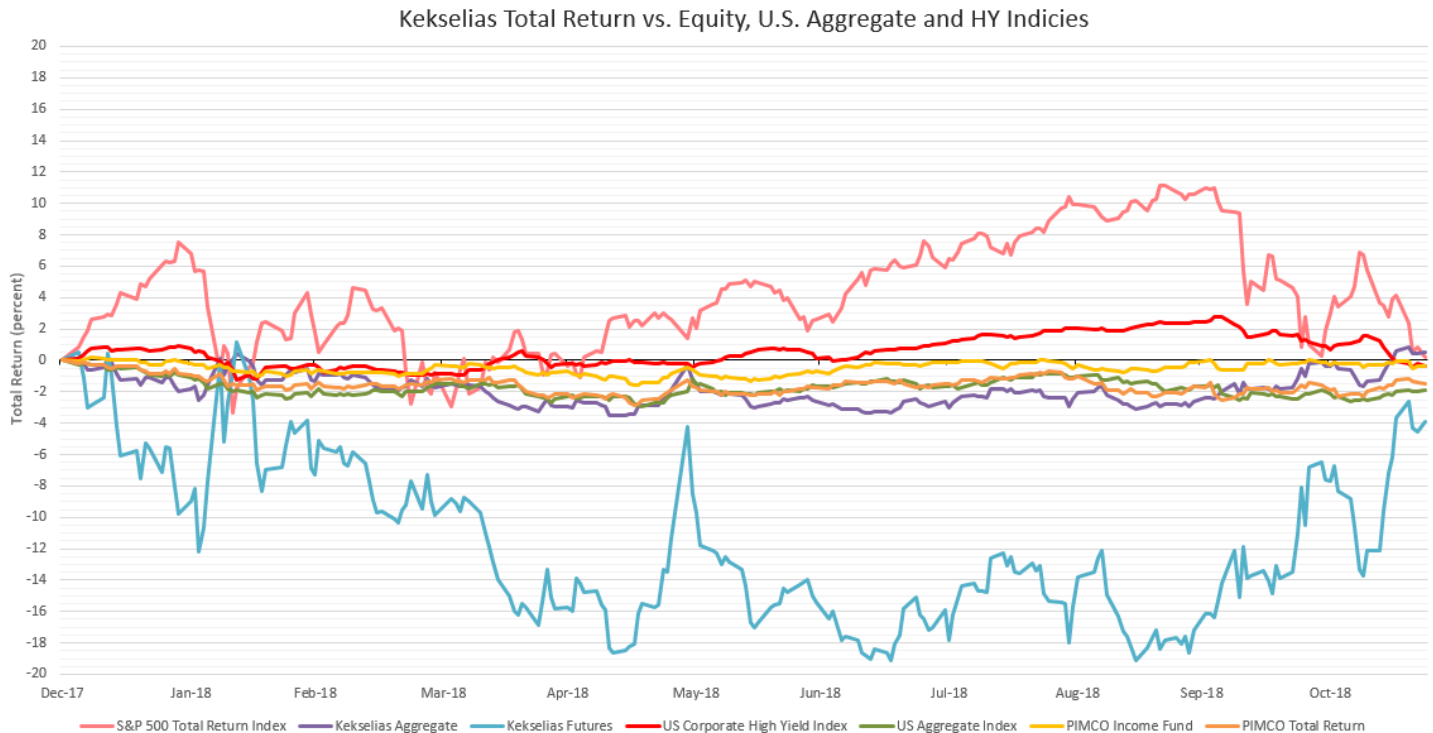
This has acted as a tailwind for prudent portfolio managers, as nearly a decade of relentless risk-taking led to rising number of research citing festering financial stability risks in the non-bank sector. In his [November 19 speech at the People’s Bank of China](#) (the first central banks to enact pre-emptive deleveraging policies since the Great Recession), Bank for International Settlement General Manager Carstens cited work by Shin and Borio to highlight unintended side effects of prolonged monetary easing and markets’ [rising vulnerability to “snapback” risks in long-maturity bonds](#):

- Accumulation in sovereign and corporate debt fueled by easy financial conditions (rising interest rate sensitivity)
- Shift in the supply of credit from bank financing to bond financing (rates sensitivity shifts to longer-term)
- Intense search-for-yield and compressed term premia reflect excessive risk-taking (rising risk-parity exposure)
- Asset managers created an illusion of liquidity at times of low volatility (rising non-bank instability risks)

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Aligned with BIS, PBOC and Bundesbank outlook on stability risks, the Kekselias portfolio benefited from its bearish risk-parity thesis via T-bills and futures instruments amid concurrent weakness in long duration bonds, credit and illiquid instruments (private and esoteric assets), as well as traditional risk centers such as equities and high yield.

As of November 23rd, portfolio YTD return totaled 0.553% (dark blue line below). This exceeded S&P 500 (0.186%), Bloomberg U.S. Aggregate (-1.924%), PIMCO Income (-0.331%) and Total Return (-1.478%) Funds:



Furthermore, T-bills is acting as a positive-carry hedge for the portfolio's bullish volatility expressions such as 5s30s curve steepener and front-end long (both are positive carry expressions as well):

- A more hawkish (less gradual) rate path will lift front-end interest rates (including T-bills) to boost portfolio carry and offset losses in curve steepener and front-end long
- Broader bond market volatility (higher long-term interest rates) would exert pressure on the portfolio's front-end long, but this would also increase T-bills' carry

Conversely, if financial conditions continue to tighten and unnerv FOMC participants to shift rate hike expectations (lower short-term rates and reduced T-bill yields), the portfolio's bullish positions in short-term Treasuries and 5s30s yield curve steepener (yield differential between 5-year Treasury notes and 30-year Treasury bonds to widen) would more than offset lower T-bill returns. Nevertheless, the preferred scenario for the portfolio would be further rise in bond yields across the curve (stronger headwinds to credit and risk assets), for front-end long would ideally act as an insurance policy.

T-bills are benefiting from an array of risk catalysts in the present:

- Higher fiscal deficit would generate higher short-term Treasury issuance thanks to Secretary Mnuchin and TBAC's bias to avoid higher long-bond supply (fearing further tightening in non-bank financial conditions)
- Discontent from [persistent inequality](#) fueled the rise of anti-establish political mavericks to threaten past decades' global supply chain optimization and international labor flow, which are disinflationary catalysts
- Despite recent bouts of volatility, global central banks remain on course to normalize policy to lift term premium and pare volatility suppression regimes over the near-term

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T-bills' institutional stigma persists as fund managers disparage "cash"

Despite T-bills' strong performance, the rise in short-term bond yields did little to boost broader fund returns amid risk-parity unwind, for a decade of "reach-for-yield" has steered investors toward "sophisticated" investment strategies in order to extract returns amid central banks' volatility suppression.

Complex derivatives, "Greeks," and esoteric assets dominated investor psyche during this period and fueled the rise of alternative investments, as impacts from "whatever it takes" policy response permeated all layers of financial markets. As a result, investors who focused on quality, liquidity and volatility tolerance – characteristics of T-bills - were punished. Cash in turn went from a viable asset allocation to become a source stigma as institutional investors persistently rushed to "[put cash to work](#)" to combat effects of low rates.

Therefore, many asset managers remain hesitant to hold T-bills in size for fears of being chastised by peers and clients for being "inactive." Given many institutional fund managers' compensation, many also feared that "unsophisticated" fund allocations such as T-bills would not justify their pay and potentially tarnish their firms' prestige. Not wanting to appear "out of smart ideas," many managers conformed to institutional biases toward complexity rather than following the adage that there is a time and place for everything.

Not surprisingly, T-bills will likely remain a versatile instrument in the tool kit for outcome-driven investors who are willing to tolerate reputation impacts and peer pressure over "holding cash," especially if they hold a view that this year's volatility spike are merely the opening salvo of a paradigm shift away from the post-crisis "new normal."

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